



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201013072**

Release Date: 4/2/10

Date: January 07, 2010

Contact Person:

Identification Number:

Uniform Issue List:

4943.03-1

Telephone Number:

Legend:

Employer Identification Number:

Director1 =
Director2 =
Director3 =
Director4 =
Son/Employee =
Corporation =

Dear

This is in reply to your ruling request dated August 28, 2006, from your authorized representatives, as modified by your letter dated August 7, 2008, regarding the proposed recapitalization of Corporation and related actions pursuant to sections 4943 and 511 of the Internal Revenue Code ("Code").

FACTS

According to the information provided by you, you are recognized as exempt from federal income tax under section 501(c)(3) of the Code and are classified as a private foundation within the meaning of section 509(a). You carry out your charitable purposes through discretionary donations made for the public welfare, including charitable, scientific, literary, and educational purposes. You also distribute grants to other organizations, enterprises, and individuals with like purposes. The current members of your board of directors are Director1, Director2, Director3, and Director4. Director1 and Director2 are married to each other. Director3, Director4, and Son/Employee are the adult children of Director1 and Director2. Son/Employee is a current full time employee and shareholder of Corporation.

Corporation is a for-profit corporation actively engaged in a trade or business (as described in section 53.4943-8(c) of the regulations) that is not substantially related to your exempt purpose within the meaning of section 513(a) of the Code. Corporation is employee-owned and Director1 owns less than 40 percent of the outstanding shares of stock entitled to vote. Employees may purchase and sell stock at predetermined values through Corporation's employee stock purchase plan. Corporation currently has five classes of capital stock, none of which is directly owned by you. The specific attributes and current shareholders of each class of stock are:

Class A Stock: This class of stock is held only by active employees who are not family members of Director1 or Director2. Holders of this class of stock are entitled to one vote per share and may vote to elect directors and on other major transactions including mergers, charter amendments, the sale of all assets, and where required by law.

Class B Stock: This class of stock is held only by retired employees who are not family members of Director1 or Director2. Holders of this class of stock are not entitled to vote to elect directors or on any other transaction except where required by law.

Class C1 Stock: This class of stock is held only by (or in trust for) descendants of Director1 who are active employees of Corporation. Holders of this class of stock are entitled to one vote per share and may vote to elect directors and on other major transactions including mergers, charter amendments, the sale of all assets, and where required by law. All outstanding shares of this class of stock are currently held by Son/Employee.

Class C2 Stock: This class of stock is held only by (or in trust for) descendants of Director1 who are not employed by Corporation. Holders of class C2 stock are not entitled to vote to elect directors or on any other transaction except where required by law.

Class D Stock: This class of stock is held only by (or in trust for) Director1. Holders of this class of stock are entitled to one vote per share and may vote to elect directors and on other major transactions including mergers, charter amendments, the sale of all assets, and where required by law.

All classes of stock retain the same rights to dividends and liquidation proceeds, and no class of stock has contingent voting rights or rights of first refusal. Director1 intends on transferring a number of shares of Corporation stock to you. Before this occurs, Corporation will undergo a recapitalization plan. First, Corporation will amend its charter to provide for an exchange of all class D shares for newly created class D1 and class D2 shares. Holders of Class D1 shares will be entitled to one vote per share and may vote to elect directors and on other major transactions including mergers, charter amendments, the sale of all assets, and where required by law. Holders of Class D2 shares will not be entitled to vote to elect directors or on any other transaction except where required by law. Holders of Class B, class C2, and class D2 shares of stock are not entitled to vote to elect directors and these shares are referred to as nonvoting stock.

The allocation of class D shares to class D1 and D2 shares will be made such that the class D1 shares will constitute no more than 15 percent of all shares of any class entitled to vote to elect directors. After the recapitalization, the voting power of the class C1 shares will be less than 5 percent. Director1 will then transfer all class D1 shares to you within three years of the issuance of this ruling. Upon the death of Director1, any remaining class D1 and all class D2 shares will be transferred to you. At the time that class D1 shares are transferred to you, the shares of class D1 in combination with class C1 will be less than 20% of all outstanding voting stock of Corporation.

None of the shares of Corporation held by you will be subject to an acquisition indebtedness as described in section 514(c).

You have requested the following rulings:

1. Ownership of some nonvoting stock and all class D1 stock of Corporation, by you, will not constitute excess business holdings for purposes of section 4943 if the Code.
2. Dividends and income received by you on nonvoting stock of Corporation, will not constitute unrelated business taxable income under section 511 of the Code.

LAW

Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable or educational purposes.

Section 509(a) of the Code provides that, unless specifically excepted, a domestic or foreign organization described in section 501(c)(3) is a private foundation and subject to the excise taxes of Chapter 42.

Section 511 of the Code, in part, imposes a tax on the unrelated business taxable income of organizations described in section 501(c)(3).

Section 512(a)(1) of the Code describes the term "unrelated business taxable income" as the gross income derived by an exempt organization from any unrelated trade or business, as defined under section 513, regularly carried on by it, less certain deductions, but with modifications provided in section 512(b).

Section 512(b) of the Code sets forth various modifications, which exclude certain income from the computation of unrelated business taxable income. These modifications include dividends, interest, royalties, rent from real property, and gain from the sale of property.

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt purpose or function.

Section 4943(a) of the Code imposes a tax on the excess business holdings of any private foundation in a business enterprise during any taxable year.

Section 4943(c)(1) of the Code defines the term "excess business holdings" as the amount of stock in a corporation that a foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in the corporation to be permitted holdings.

Section 4943(c)(2) of the Code limits the holdings of a private foundation in a corporation to 20 percent of the voting stock of the business enterprise, reduced by the percentage of the voting stock owned by all disqualified persons.

Section 4943(c)(2)(A) of the Code provides that the permitted holdings of any private foundation in an incorporated business enterprise are:

- (i) 20 percent of the voting stock, reduced by
- (ii) The percentage of the voting stock owned by all disqualified persons.

Section 4943(d)(1) of the Code defines business holdings as in computing the holdings of a private foundation, or a disqualified person with respect thereto, in any business enterprise, any stock or other interest owned, directly or indirectly, by or for a corporation shall be considered as being owned proportionately by or for its shareholders.

Section 4946(a)(1) of the Code provides that for the purposes of section 4943 the term "disqualified person" includes both foundation managers and family members of any foundation manager.

Section 4946(b)(1) of the Code provides that a foundation manager is, with respect to any private foundation, an officer, director, or trustee of the foundation.

Section 4946(d) of the Code provides that the term "family member," as used in section 4946(a), includes a spouse, children, grandchildren, great grandchildren, any spouses thereof, and ancestors.

Section 53.4943-1 of the Foundation and Similar Excise Taxes Regulations ("regulations") provides that generally, under section 4943 of the Code, the combined holdings of a private foundation and all disqualified persons (as defined in section 4946(a)) in any corporation conducting a business which is not substantially related to the exempt purpose of the foundation are limited to 20 percent of the voting stock in such corporation.

Section 53.4943-3(b)(1)(i) of the regulations provides that except as otherwise provided in section 4943(c)(2) and (4), the permitted holdings of any private foundation in an incorporated business enterprise are-(A) 20 percent of the voting stock in such enterprise reduced (but not below zero) by (B) the percent of voting stock in such enterprise actually or constructively owned by all disqualified persons.

Section 53.4943-3(b)(1)(ii) of the regulations provides that the percentage of voting stock held by any person in a corporation is normally determined by reference to the power of stock to vote for the election of directors, with treasury stock and stock which is authorized but unissued being disregarded.

Section 53.4943-3(b)(2)(i) of the regulations provides that in general, in addition to those holdings permitted by paragraph (b)(1) of this section, the permitted holdings of a private foundation in an incorporated business enterprise shall include any share of nonvoting stock in such enterprise held by the foundation in any case in which all disqualified persons hold no more than 20 percent of the voting stock in such enterprise. All equity interests which do not have voting power attributable to them shall, for purposes of section 4943, be classified as nonvoting stock. For this purpose, evidence of indebtedness (including convertible indebtedness), and warrants and other options or rights to acquire stock shall not be considered equity interests.

ANALYSIS

Ruling 1

Director1, Director2, Director3, and Director4 are the current members of your board of directors. Son/Employee is the adult child of Director1 and Director2. Section 4946(a)(1) of the Code provides that the term disqualified person includes both foundation managers and family members of any foundation manager. Pursuant to section 4946(b)(1), the directors of a private foundation qualify as foundation managers. Director1, Director2, Director3, and Director4 are therefore disqualified persons by way of being your foundation managers. Son/Employee is also a disqualified person because Son/Employee is a family member of Director1 and Director2.

Section 4943(a) of the Code imposes a tax on the business holdings of any private foundation in a business enterprise in excess of the foundation's maximum permitted holdings in that enterprise. Pursuant to sections 4943(c)(1) and 4943(d)(1), the capital stock in Corporation held by Director1, Director2, Director3, Director4, and Son/Employee is included in determining your maximum permitted holdings in Corporation. Pursuant to section 4943(c)(2) of the Code and sections 53.4943-1 and 53.4943-3(b)(1)(i) of the regulations, your maximum permitted holdings of Corporation is 20 percent of the voting stock reduced by the percentage of voting stock owned by all disqualified persons. Because section 53.4943-3(b)(1)(ii) of the regulations provides that voting stock is determined by reference to the power of stock to vote for election of directors, your maximum permitted holdings are reduced by any class A, C1, and D1 stock owned by Director1, Director2, Director3, Director4, and Son/Employee. Classes B, C2, and D2 stock are nonvoting and therefore do not reduce your maximum permitted holdings under section 4943(c)(2). Only the ownership and attributes of classes A, C1, and D1 stock require further analysis:

Class A Stock: The outstanding shares of class A stock are held only by active employees that are not descendants of Director1. Neither you nor any disqualified persons therefore own any class A stock and any outstanding shares will not reduce your maximum permitted holdings.

Class C1 Stock: The outstanding shares of class C1 stock are held by Son/Employee, a disqualified person and will therefore reduce your maximum permitted holdings.

Class D1 Stock: After the recapitalization plan the total outstanding shares of class D1 stock will constitute no more than 15 percent of all shares of any class entitled to vote to elect directors. All of these outstanding shares will be held at first by Director1, a disqualified person, and then transferred directly to you. Thus, the outstanding shares of class D1 stock will reduce your maximum permitted holdings.

The total of outstanding shares of voting stock is calculated via the summation of the total outstanding shares of class A, C1, and D1 stock. Because you have represented that your direct and attributable ownership of class C1 and D1 stock after the recapitalization will be less than 20 percent of all of the total outstanding shares of voting stock, your ownership of class C1 and D1 stock will be permitted holdings under section 4943(c)(2)(A) of the Code.

With regard to your direct and indirect ownership of the nonvoting stock, class B, C2, and D2 stock, pursuant to section 53.4943-3(b)(2)(i) of the regulations, the permitted holdings of a private

foundation in an incorporated business enterprise shall also include any share of nonvoting stock in such enterprise held by the foundation in any case in which all disqualified persons hold no more than 20 percent of the voting stock in such enterprise. Because of your representations that you and your associated disqualified persons own less than 20 percent of all of the voting stock of Corporation, your ownership of nonvoting shares of Corporation stock, after the recapitalization, will therefore be permitted holdings under section 4943(c)(2)(A) of the Code. Thus, your ownership of some nonvoting stock and all class D1 stock of Corporation will not constitute excess business holdings for purposes of section 4943 of the Code.

Ruling 2

Section 512(b)(1) of the Code excludes dividends from qualifying as unrelated business taxable income. Section 512(b)(5) excludes all gains or losses recognized in connection with a tax exempt organization's investment activities. Section 512(b)(4) excepts from these provisions certain income from debt-financed property, but you have represented that your stock in Corporation will not be subject to an acquisition indebtedness and thus not constitute debt-financed property. Pursuant to these modifications to the unrelated business taxable income rules, any dividends or gains you receive from your possession or sale of nonvoting stock will not constitute unrelated business taxable income. Dividends and income received by you on nonvoting stock of Corporation, will not constitute unrelated business taxable income under section 511 of the Code.

RULINGS

1. Your ownership of some nonvoting stock and all class D1 stock of Corporation, by you, will not constitute excess business holdings for purposes of section 4943 if the Code.
2. Dividends and income received by you on nonvoting stock of Corporation will not constitute unrelated business taxable income under section 511 of the Code.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. Any changes that may have a bearing upon your tax status should be reported to the Service. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records. Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Except as we have specifically ruled herein, we express no opinion as to the consequences of this transaction under the cited provisions or under any other provision of the Code.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

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If there are any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Manager, Exempt Organizations
Technical Group 2

Enclosure
Notice 437